

Message Text

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46

ACTION ARA-10

INFO OCT-01 EUR-12 ISO-00 DHA-02 ORM-02 SP-02 USIA-06

AID-05 EB-07 NSC-05 CIEP-01 TRSE-00 SS-15 STR-04

OMB-01 CEA-01 COME-00 CIAE-00 FRB-03 INR-07 NSAE-00

XMB-02 OPIC-03 LAB-04 SIL-01 L-03 H-02 DODE-00 PA-01

PRS-01 AGR-05 INT-05 FEAE-00 CU-02 /113 W

----- 025478

R 061413Z JUL 76

FM AMEMBASSY SANTIAGO

TO SECSTATE WASHDC 0126

INFO AMEMBASSY BRASILIA

AMEMBASSY BUENOS AIRES

AMEMBASSY LIMA

AMEMBASSY BOGOTA

AMEMBASSY CARACAS

AMEMBASSY QUITO

AMEMBASSY LA PAZ

AMEMBASSY LONDON

AMEMBASSY PARIS

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EO 11652: N/A

TAGS: AFIN, AFSP, EFIN, CI

SUBJECT: PINOCHET/CAUAS' ECONOMIC TAKE-OFF ON THE WING

REF: LIMITED OFFICIAL USE SANTIAGO 6353

1. SUMMARY. IN THE TWO DAYS FOLLOWING THE PINOCHET/CAUAS
SPEECHES (REFTEL) THE GOC HAS ORCHESTRATED A MASSIVE CAMPAIGN
TO DEFLATE INFLATIONARY EXPECTATIONS AND TO ENCOURAGE A REVIVAL
OF THE ECONOMY. PRICES OF MANY CONTROLLED ITEMS WERE LOWERED
BY OFFICIAL DECREE AND PRODUCERS OF SOME OTHER ITEMS NOT SUBJECT
TO CONTROLS FOUND IT EXPEDIENT TO LOWER THEIR PRICES. MONTHLY

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INTEREST RATES IN THE LOCAL CAPITAL MARKET FELL BY ABOUT THREE

PERCENTAGE POINTS. THE PRESIDENT OF THE CHILEAN MANUFACTURERS' ASSOCIATION (SOFOFA) ANNOUNCED THAT INDUSTRIAL PRODUCERS WOULD FREEZE THEIR PRICES FOR SIXTY DAYS. THE GOC ALSO GAVE SOME OF THE PARTICULARS ON TAX REDUCTIONS. THIS EXERCISE IN BOOSTERISM SHOULD HAVE GRATIFYING SHORT-TERM EFFECTS ON PRICES AND SALES BUT WILL PROBABLY HAVE A TARIFF IMPACT ON OUTPUT AND EMPLOYMENT. END SUMMARY.

2. ON THE DAY FOLLOWING THE PINOCHET/CAUAS SPEECHES ANNOUNCING A NEW PHASE OF CHILE'S ECONOMIC RECOVERY, THE GOC DECREED PRICE REDUCTIONS OF SEVERAL CONTROLLED CONSUMER ITEMS INCLUDING BREAD, PASTA, FLOUR, GASOLINE, AND PUBLIC TRANSPORTATION. SANTIAGO NEWSPAPER SURVEYS INDICATE THAT MANY CONSUMER ITEMS SUCH AS SHOES HAD ALSO BEEN LOWERED IN PRICE. JUNTA MEMBER ADMIRAL MERINO BOASTED IN AN INTERVIEW WITH SANTIAGO DAILY LA TERCERA THAT CHILE WAS THE ONLY COUNTRY IN THE WORLD WHICH IS ABLE TO LOWER ITS CONSUMER PRICE INDEX.

3. CHILEAN INDUSTRIAL PRODUCERS, (EITHER THROUGH COERCION OR AN APPRECIATIVE READING OF GOC EXPECTATIONS) ANNOUNCED VIA THE PRESIDENT OF SOFOFA THAT PRICES OF INDUSTRIAL GOODS WOULD BE HELD CONSTANT FOR SIXTY DAYS. SINCE THE EXCHANGE RATE APPEARS UNLIKELY TO REACH ITS PRE-JUNE 29 LEVEL DURING THIS PERIOD, COST-PUSH PRESSURES ON PRODUCER PRICES SHOULD BE MINIMAL FOR THE NEXT SIXTY DAYS. CAPACITY UTILIZATION FOR MOST INDUSTRIES IS AT SUCH A LOW LEVEL THAT DEMAND-PULL PRESSURES ON PRICES OF MOST INDUSTRIAL PRODUCTS SHOULD, ON THE WORST POSSIBLE ASSUMPTIONS, BE MODERATE.

4. TO PROTECT DOMESTIC PRODUCERS FROM UNFAIR FOREIGN COMPETITION, THE TARIFF POLICY COMMITTEE HAS BEEN AUTHORIZED TO BEGIN ACCEPTING COMPLAINTS OF DUMPING BY FOREIGN PRODUCERS. THE GOC CLAIMS TO HAVE EVIDENCE OF THE DUMPING OF FOREIGN TEXTILES. THE LOWER EXCHANGE RATE IS LIKELY TO FOSTER OTHER COMPLAINTS IN THE WEEKS AHEAD AS LOCAL PRODUCERS FEEL THE PINCH OF FOREIGN COMPETITION, MUCH OF WHICH WILL DOUBTLESS BE DESCRIBED AS DUMPING.

5. THE GOC IS ALSO SEEKING TO BOLSTER THE INCOME EFFECT OF THE NEW POLICIES BY OFFERING PROMISES OF FUTURE TAX CUTS.

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ALTHOUGH VAGUE AS TO THE ACTUAL TIMING OF ANY REDUCTIONS, THE DIRECTOR OF INTERNAL REVENUE INDICATED THAT THE FIVE PERCENT EMPLOYMENT TAX WOULD BE ELIMINATED AND THAT THE MINIMUM TAX EXEMPTION RATE WOULD BE RAISED. THE EFFECTIVE RATE OF THE VALUE ADDED TAX APPARENTLY WILL ALSO BE LOWERED, EVEN AS ITS COVERAGE IS EXTENDED TO SUCH BASICS AS BREAD, MILK, AND FRUITS. A HIDDEN SUBSIDY TO LOWER INCOME GROUPS HAS THUS BEEN WITHDRAWN. EXEMPTIONS FOR SPORTS EVENTS, EARLIER LIMITED

TO FOOTBALL, WILL BE WIDENED TO INCLUDE OTHER SPORTS. THUS
HAVING DEMONSTRATED ITS CONCERN FOR SPORTS, THE REGIME WILL
ALSO EXEMPT OPERA AND BALLET.

6. COMMENT: THE PRESIDENT OF THE CENTRAL BANK EXPRESSED
SOME RESERVATIONS TO THE AMBASSADOR ABOUT THE EXTENT TO WHICH
THESE FAIRLY MODEST MEASURES HAD BEEN BALLYHOOED BY THE PRESS.
(FOR THIS THE GOC IS UNDOUBTEDLY CULPABLE.) CAN THE DECELERATION
OF INFLATION BE SUSTAINED BEYOND THIS INITIAL PERIOD WHEN
SPECIAL CIRCUMSTANCES OPERATE, OR WILL INFLATION CONTINUE AT
A NEW THOUGH LOWER FAIRLY CONSTANT LEVEL, SAY THREE PERCENT
A MONTH? PERHAPS INDICATIVE OF THAT, INTEREST RATES IN THE
LOCAL CAPITAL MARKET, THOUGH NOW AT A SUBSTANTIALLY LOWER
LEVEL, STILL INCORPORATE A SIZABLE INFLATION PREMIUM. THE
QUESTION IS RAISED AMONG LOCAL ECONOMISTS WHETHER A REDUCTION
EVEN OF THIS EXTRAORDINARY MAGNITUDE, FROM 211 PERCENT DURING
THE PAST TWELVE MONTHS TO 40-50 PERCENT A YEAR, WOULD STILL
BE ENOUGH TO PERMIT THE STABILITY ON WHICH CHILE'S FUTURE
GROWTH AND PROSPERITY ULTIMATELY WILL DEPEND.

7. OVER THE SHORTER TERM, FOR ECONOMIC, SOCIAL, AND POLITICAL
REASONS THE GOC IS VERY DESIROUS OF STIMULATING EMPLOYMENT.
THE UNEMPLOYMENT RATE HAS HUNG CLOSE TO THE 20 PERCENT LEVEL
FOR THE LAST SEVEN OR EIGHT MONTHS, DESPITE PERSISTENT PRO-
NOUNCEMENTS OF IMPENDING IMPROVEMENT. WE ARE WAITING TO SEE
IF ADDITIONAL CONSUMER DEMAND CAN BE CHanneLED TOWARD DOMESTIC
GOODS (IN THE ABSENCE OF MORE PROTECTIONIST POLICIES) TO MAKE
A DRAMATIC DENT IN THE UNEMPLOYMENT RATE DURING THE SECOND
HALF OF 1976.
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